Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Verizon Petition for	)	WC Docket No. 02-202
Emergency Declaratory and	)	
Other Relief	)	

COMMENTS OF SBC COMMUNICATIONS INC.

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SBC Communications Inc. (SBC) strongly supports Verizon's Emergency Petition for a Declaratory Ruling and Other Relief. In particular, SBC supports Verizon's request that the Commission: (1) permit carriers expeditiously to revise their tariffs to provide adequate assurance of payment for services rendered to financially troubled companies; (2) support ILECs' efforts in Bankruptcy Courts to obtain advance payment for services rendered to bankrupt companies; and (3) confirm that carriers seeking to take the benefits of existing service arrangements of bankrupt carriers must pay a cure for outstanding debts on those arrangements — consistent with bankruptcy law and federal tariffs. Taken together, these steps will further the Commission's goals of ensuring continuity of service for consumers, while, at the same time, maintaining the integrity and reliability of the Nation's telecommunications network by limiting the impact of bankruptcies and other failures on telecommunications service providers that must continue to serve financially distressed companies.

I. INTRODUCTION AND SUMMARY.

The telecommunications industry is in a state of crisis.[1] Since the technology bubble burst almost two years ago, the industry has been beset by bankruptcies and declining capital investment. More than 50 carriers have filed for bankruptcy and nearly 500,000 employees have lost their jobs.[2] Over the past two years, the industry has lost approximately $2 trillion of market value.[3] This precipitous decline in market capitalization has affected every segment of the industry — the long distance industry is down 68 percent year-to-date, the wireless industry is down 71 percent, and ILECs are down 40 percent.[4]

The downturn in the telecommunications industry has not only hurt new entrants. Rather, because of the "interconnected and inter-dependent nature of the telecom network," the failure of some CLECs whose business plans were flawed "has caused collateral damage across the industry,"[5] including to ILECs. SBC, for example, has been forced to shoulder hundreds of millions in unpaid debts, most of which have been due for access services provided to other carriers, in 53 bankruptcies over the past two years. WorldCom, alone, owed SBC over $300 million when it filed for bankruptcy.

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[1] Yochi J. Dreazen, *FCC's Powell Says Telecom 'Crisis' May Allow a Bell to Buy WorldCom*, WALL ST. J., July 15, 2002, at A1.

[2] Written Statement of Michael K. Powell, Chairman, Federal Communications Commission, on "Financial Turmoil in the Telecommunications Marketplace: Maintaining the Operations of Essential Communications," Before the Committee on Commerce, Science, and Transportation, United State Senate (July 30, 2002) (*Powell Statement*).

[3] *Id.*

[4] *Id.*

[5] *Id.*

Nor is there any light at the end of the tunnel. The industry is staggering under nearly $1 trillion in debt.[6] And wireline revenues have fallen as, for the first time since the Great Depression, the number of local phone lines has declined. ILEC revenues, in particular, have plummeted, as they have lost millions of their most lucrative lines, undermining their ability and incentive to invest in new technologies, and retain the employees who operate and maintain the network. These losses are not due to genuine, facilities-based competition, but rather to "synthetic competition" created by pervasive unbundling, and, in particular, the UNE-P, which simply transfers wealth from incumbent facilities-based carriers to companies that make no investments of their own. SBC has been losing more than 200,000 lines per month to the UNE-P, and these losses are rapidly accelerating (in June, SBC lost 270,000 lines to the UNE-P). For every line lost to the UNE-P, SBC and other ILECs lose 60 percent of the revenue, but retain 95 percent of the costs, of the line.[7]

These economics are unsustainable. With revenues falling, bad debt from WorldCom and other CLECs mounting, and regulatory policies preventing them from realizing the fruits of their investments, incumbent LECs cannot justify new capital investment. But without such investment, the industry as a whole will not recover; rather, it will remain locked in an ever widening spiral to the bottom. In the end, consumers, investors, and the economy at large will be the losers.

The Commission must act now to restore financial stability and economic rationality to the market, and thus lift the telecommunications industry out of this crisis. First, the

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[6] *Powell Statement*.

[7] J.P. Morgan Securities Inc., *Industry Update – No Growth Expected for the Bells in 2003* (July 12, 2002).

Commission immediately must take steps to ensure that the financial problems afflicting some carriers do not infect those struggling to maintain their financial health by ensuring that carriers have adequate assurance that they will be paid for services they are required to render to financially troubled companies. In particular, the Commission should grant Verizon's petition, and (1) permit carriers expeditiously to implement revisions to their tariffs to provide adequate assurance of payment for services rendered to financially troubled companies; (2) support ILECs' efforts in Bankruptcy Courts to obtain advance payment for services rendered to bankrupt companies; and (3) confirm that carriers seeking to take the benefits of existing service arrangements of bankrupt carriers must pay a cure for outstanding debts on those arrangements — consistent with bankruptcy law and federal tariffs. These measures will restore much needed financial stability to the industry, maintain continuity of service for end-users, and provide for an orderly and seamless transition of customers, where necessary.

More fundamentally, and equally important, the Commission must, at long last, establish economically rational local competition policies that restore long-term health to the telecommunications industry. In particular, the Commission must, as Chairman Powell, and Commissioners Abernathy and Martin all have recognized, adopt policies that promote real, facilities-based competition;[8] the kind that can serve as an engine for lower prices, better service, and more innovation and investment.

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[8] Response of Michael K. Powell, to Senator Hollings ("[F]acilities-based competition holds the most promise, in the long run, for sustained competition and the consumer benefits it brings. Facilities-based competition creates greater opportunity for innovation and price differentiation. . . . [I]nvestment in facilities also furthers public safety and infrastructure development goals, which have become increasingly important since the events of September 11th."); Kathleen Q. Abernathy, Commissioner, FCC, *My View from the Doorstep of FCC Change*, 54 Fed. Comm. L.J. 199, 206-07 (2002) ("*facilities-based* competition . . . is the most viable strategy in the long term and the one most likely to benefit consumers") (emphasis in original); Kevin J. Martin, Commissioner, FCC, *Framework for Broadband Deployment*, Remarks at the National Summit

Too often in the past, regulators have focused instead on promoting the fastest possible entry by the maximum number of "competitors." This focus on "jump-starting" competition has resulted in maximum unbundling, and led state regulators (who have been reluctant to rebalance local rates as required by the Act) to ratchet UNE prices ever lower in an effort to spur the appearance of competition.[9] In the end, these policies have devalued the investments of facilities-based CLECs, which must compete with the "UNE-P forever" CLECs, and discouraged further investment by CLECs and ILECs alike.

SBC applauds the Commission for recognizing the need for change, and for initiating a comprehensive review of its local competition policies through, among other things, the *Triennial Review*, the *Broadband Title I* proceeding, and the *Broadband Title II* proceeding. These proceedings are critical to restoring long-term economic health and rationality to telecommunications markets. The Commission therefore must complete action in these proceedings expeditiously.[10]

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on Broadband Deployment, Washington, D.C. (Oct. 26, 2001) ("to get to true deregulation, we need facilities-based competition").

[9] As Chairman Powell has observed, rather than rebalance rates to encourage real competition, states have made wholesale rates "confiscator[ily] cheap." Fred Dawson & Kim Sunderland, *Interview: FCC Chairman Michael Powell*, Phone+ (Apr. 2002), at http://www.phoneplusmag.com/articles/241INTERVIEW.html.

[10] The Commission therefore should reject CompTel's and ALTS' request to freeze action in these proceedings. Letter of H. Russel Frisby Jr., CompTel, and John D. Windhausen Jr., ALTS, to Michael Powell, Chairman, FCC (July 19, 2002). Their request is simply aimed at preserving unbundling rules that the D.C. Circuit has found unlawful.

II. THE COMMISSION SHOULD PERMIT CARRIERS TO REVISE THEIR TARIFFS TO PROVIDE ADEQUATE ASSURANCE OF PAYMENT.

Over the past several weeks, SBC and other ILECs have filed tariff revisions to provide themselves additional protection against unpaid debt from financially distressed customers. SBC's revisions give it the right to seek a one month deposit or other assurance of payment for services provided to customers that pose a serious risk of future non-payments because they have impaired credit worthiness. In lieu of a cash deposit, customers may choose one of three other options specified in the tariff – a letter or credit, a letter of guarantee, or a one-month pre-payment. The tariff defines "impairment of creditworthiness" in a clear and objective manner, drawing on criteria from third party sources, and encompasses only those customers whose credit ratings have fallen so low as to raise a significant risk of default on amounts owed for services. SBC also has proposed to reduce the notice period for refusing additional requests for service or discontinuing service, enabling SBC to mitigate its losses in the event a carrier fails to make payment. SBC has limited these measures to customers whose most recent monthly bills (including outstanding balances) for interstate access services total $1 million or more, and thus sought to tailor these measures to meet the extraordinary threat of a substantial loss if these customers default on amounts owed for services.

These revisions are necessary to provide SBC greater assurance of payment for services rendered to financially troubled companies. SBC's existing tariffs permit it to require deposits only from carriers with a history of late payments or with no established credit. And they prevent SBC from taking reasonable steps to mitigate the risk of non-payment by requiring SBC to provide a carrier 30 days notice that a deposit is required, and an additional 30 days notice that service will be disconnected if the carrier fails to pay the deposit. Experience over the past year has shown that carriers with no history of late payment, but whose credit ratings have been reduced, quickly can succumb in the turmoil roiling the telecommunications industry, leaving SBC holding the bag for millions of dollars owed for services rendered. In the case of the largest carriers, which purchase tens (in some cases, hundreds) of millions of dollars in monthly access services, the amounts owed have reached staggering proportions before SBC could take steps to protect itself. The sudden collapse of WorldCom exemplifies the inadequacy of SBC's and other ILECs' tariffs to provide adequate assurance of payment for services rendered to financially troubled carriers. As noted above, when it filed for bankruptcy, WorldCom owed SBC's operating companies over $300 million, much of which could be lost in bankruptcy. SBC had no opportunity to protect itself against these losses because WorldCom did not have a history of late payment until shortly before it filed for bankruptcy. Likewise, Global Crossing, Winstar and others were timely payers until just before they filed for bankruptcy. SBC's existing deposit requirements thus provide too little protection too late. The revisions SBC has proposed address this problem, and they do so in a way that is narrowly tailored to strike a balance between SBC's need for a higher level of protection against bad debt and the cash flow concerns of financially troubled customers.

The revisions SBC has proposed simply grant it the same protections available to other suppliers in dealing with credit impaired customers. Other suppliers routinely demand deposits, prepayments and letters of guarantee or credit before continuing to provide services to financially troubled firms.[11] And, unlike SBC, such suppliers have no obligation to continue to provide service post-bankruptcy. Preventing SBC from using these same measures will do

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[11] *See* Jeffry Bartash, *WorldCom files for Chapter 11* (July 21, 2002), www.cbs.marketwatch.com (noting that "nervous WorldCom suppliers have demanded upfront payment").

nothing more than put it at the back of the line, behind other suppliers of equipment and services, and increasing the risk that it will not be paid for the services it provides.

As Verizon observes in its petition, the Commission previously has approved similar tariff changes, and should approve the revisions SBC and others have submitted to provide adequate assurance of payment from financially distressed firms.[12] Moreover, the revisions SBC has proposed are far less draconian than the measures proposed by CLECs and others to obtain assurance of payment in, for example, the WorldCom bankruptcy proceeding. AT&T, for example, has asked for a 3 months deposit, and other major CLECs — such as Z-Tel (3 months), Cox (2 months) and e.spire (2 months) — also have asked for substantial deposits. Large Deposits also were requested by dozens of service providers, including fiber providers like NEON Optica (3 months) and Williams (1 month *plus* prepayment), SS7 provider Illuminet (2 months), backhaul transport provider Centennial Communications (3 months), and voice messaging provider Avaya (3 months). WorldCom itself asked for a 2-month deposit in the Global Crossing bankruptcy proceeding.

The revisions SBC has proposed also are less stringent than the measures adopted by other carriers to assure payment for services rendered to financially distressed companies pre-bankruptcy. For example, AT&T requires a deposit of up to three times the estimated average monthly and/or monthly recurring charges, and, Sprint requires a deposit of up to six months of

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[12] Verizon Petition at 4-5, citing *Annual 1987 Tariff Filings*, 2 FCC Rcd 280, 304-05 (1986) (permitting BellSouth to shorten the notice period for discontinuing service for non-payment in light of IXC bankruptcies), and *Affinity Network Inc. v. AT&T*, 7 FCC Rcd 7885, 7885 (1992) ("The Commission generally is disinclined to intervene in matters involving a carrier's decision to terminate service of a particular customer that has failed to pay legally effective and overdue tariffed charges for tariffed service that the carrier has duly rendered. Nor is the Commission inclined to second-guess a carrier's decision, with respect to a particular customer, *to impose deposit, advance payment, or other security arrangements* provided for in its tariff.") (emphasis added).

billable charges plus installation.[13] Particularly as SBC has tailored its proposed tariff revisions as narrowly as possible to accommodate any cash-flow concerns of its customers, the Commission should approve SBC's proposed tariff.

The Commission should, as Verizon requests, approve these tariff changes as soon as possible. As noted above, SBC already has lost hundreds of millions of dollars in unpaid debt for services rendered to carriers that later went bankrupt. And without the additional protections proposed in SBC's tariffs, SBC losses could skyrocket if the meltdown in the telecommunications industry continues unabated. SBC's top twenty-two customers account for over $300 million in monthly access service revenues, or $1 million to $120 million apiece. SBC has a right to protect itself from additional losses if these customers default on amounts owed for services. The Commission therefore should promptly authorize carriers to implement reasonable protective measures, such as those in SBC's proposed tariff revisions, to assure payment for services rendered to customers with impaired credit worthiness.

III. THE COMMISSION SHOULD SUPPORT ILEC EFFORTS IN BANKRUPTCY COURTS TO OBTAIN ADEQUATE ASSURANCE OF PAYMENT FOR SERVICES RENDERED TO BANKRUPT CUSTOMERS.

The Commission also should, as Verizon requests, support the right of carriers to receive payment in advance or other comparable measures (such as deposits) to provide adequate assurance of payment for services they continue to provide bankrupt entities. In prior bankruptcy proceedings, the Commission has urged the court to take steps to require carriers to

[13] *Verizon Telephone Companies, Tariff FCC Nos. 1, 11, 14, and 16*, Transmittal No. 226, Reply Comments of Verizon to Petitions to Reject or Suspend and Investigate at 7-8 (filed Aug. 7, 2002), *citing* AT&T Communications Tariff FCC No. 30, Long Distance Message Telecommunications Service (Interexchange Interstate), Business Telecommunications Service,

ensure continuity of service and provide a reasonable transition of customers to a new carrier, if necessary. In his recent testimony before the Senate, Chairman Powell acknowledged the importance of protecting healthy carriers from damage resulting from the failure of other carriers.[14] He further asserted that, in addition to ensuring continuity of service to consumers, the public interest demands "due consideration of the impact on other telecommunications service providers that generally must continue serving the bankrupt carrier."[15] Consistent with these pronouncements, in any bankruptcy proceeding in which it participates, the Commission should support the right of carriers to receive payment in advance or implement other measures (such as deposits) to obtain adequate assurance of payment for services they provide to a bankrupt carrier.

As the Commission knows, suppliers that continue to provide service during bankruptcy are entitled to advance payment or other adequate assurance of compensation under the bankruptcy code.[16] Bankruptcy courts, however, have considerable latitude in determining how to provide assurance of payment, including by authorizing unpaid suppliers immediately to terminate service for non-payment. In the case of a carrier like SBC, any such remedy would conflict directly with regulators' goal of maintaining continuity of service to end-users. The only way to resolve this dilemma and reconcile the public policy objectives of maintaining continuity of service for end-users, while, at the same time, providing underlying carriers (like SBC) adequate assurance of payment for services provided to bankrupt carriers, is to require bankrupt

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§§ 3.5.5(A)(1); Sprint Schedule No. 11, Business Communications Services (Interexchange Interstate), § 2.11.1.

[14] *Powell Statement* at 2.

[15] *Id.* at 5.

carriers to pay for services in advance or other comparable measures, like deposits. The Commission therefore should support ILEC efforts in bankruptcy proceedings to obtain payment in advance or other comparable measures to provide adequate assurance of payment for services they continue to provide bankrupt entities, and obviate the need for an immediate cut-off of service.

IV. The Commission Should Ensure That Any Carrier That Seeks to Retain the Benefits of a Bankrupt Carrier's Existing Service Arrangements Is Liable for a Cure.

As Verizon requests, the Commission should clarify that nothing in the Communications Act abrogates the rights of ILEC creditors to a cure under section 365 of the Bankruptcy Code (or their tariffs) for amounts due from any carrier that seeks to assume or otherwise take the benefits of a bankrupt carrier's executory service arrangements. Section 365 provides that, if a purchaser in bankruptcy wants to receive the benefits of an executory contract (such as a bankrupt CLEC's service arrangements with an ILEC), the debtor must assume that contract, assign it to the purchaser, and cure any default, including paying any outstanding debt.[17] This provision reflects congressional policy that a creditor is entitled to the benefits of its bargain, and thus a cure of pre-petition debt, in return for further performance of an executory service arrangement.

Some CLECs have claimed that the Communications Act implicitly repeals a century of bankruptcy law by entitling them to receive the benefits of a bankrupt carrier's service agreements without formally assuming the agreements or curing the debt on them. These

[16] 11 U.S.C. § 366(b).

[17] 11 U.S.C. § 365.

CLECs thus maintain that the Communications Act requires CLECs to be treated differently from every other entity purchasing assets in bankruptcy.

However, nothing in the Communications Act, the Bankruptcy Code or any court or regulatory decision supports this remarkable proposition. Nor is there anything to suggest that Congress intended to afford CLECs the unique right in bankruptcy to take the benefits of executory service arrangements with ILEC-creditors without paying a cure, or to deny ILECs alone, among all creditors, the right to a cure. Indeed, on its face, section 365 applies to all executory agreements, including telecommunications service arrangements. Absent clear expression of congressional intent to modify the rights of ILEC creditors, the Commission must construe the Communications Act in harmony with bankruptcy law, and, as part of its public interest mandate, protect innocent ILEC-creditors.[18]

The Commission itself has acknowledged that section 365 permits a debtor (and therefore its successor) to retain the benefits of an executory contract *only if* it cures all defaults under the agreement. In particular, in the *NextWave Bankruptcy* proceeding, the Commission argued that the nondischargeability of license conditions was confirmed by the Bankruptcy Code's treatment

[18] *Morton v. Mancari*, 417 U.S. 535, 551 (1974) ("When two statutes are capable of coexistence, it is the duty of the courts, absent clearly expressed congressional intention to the contrary, to regard each as effective."); *LaRose v. FCC*, 494 F.2d 1145 (D.C. Cir. 1974) (requiring the Commission to harmonize its policies under the Act with the Bankruptcy Code, and concluding that the Commission's public interest mandate under the Act includes protecting innocent creditors); *Telemundo, Inc. v. FCC*, 802 F.2d 513, 518 (D.C. Cir. 1986) (in considering an application to transfer the license of a bankrupt station, the FCC must consider the public interest in protecting innocent creditors); *Nextwave Personal Communications, Inc. v. FCC*, 254 F.3d 130, 149 (D.C. Cir. 2001) (under the Administrative Procedure Act, the court must "invalidate agency action not only if it conflicts with an agency's own statute, but also if it conflicts with another federal law."), *cert. granted*, 122 S. Ct. 1202 (2002); *Application of Parsons*, 10 F.C.C.R. 2718, 2720 (1995) (deferring to the bankruptcy court on post-petition transfer of a station and its assets "so that innocent creditors may receive the full protection afforded by federal bankruptcy law."), *aff'd*, 93 F.3d 986 (D.C. Cir. 1996) (per curiam).

of executory contracts. The Commission maintained that, "[u]nder 11 U.S.C. 365(b), a debtor may 'assume' and thereby retain the benefits of [an executory] contract *only if* it cures all defaults and provides 'adequate' assurance of future performance'; otherwise, the contract must be 'rejected.'"[19] The Commission further argued that, "[i]t is well established that a debtor *cannot* simultaneously seek 'discharge' of its obligations to make payments under such an agreement while retaining the benefits thereof; instead, *the debtor must either assume contractual duties along with the contractual benefits, or reject the contract in whole*."[20] The Commission thus has acknowledged that a debtor (and therefore its successor) in bankruptcy may *not* take the benefits of an executory agreement without assuming any outstanding liability under the agreement.

To be sure, some carriers might not be able to step into the shoes of a bankrupt carrier if they must pay the outstanding debt on the bankrupt carrier's executory service arrangements with ILECs. But that is true of any outstanding debt and in any bankruptcy. And, even in CLEC bankruptcies, CLEC-successors routinely have paid cures on executory contracts with non-ILEC creditors, even while arguing that they have no obligation to pay a cure on amounts owed to ILECs under executory service arrangements.[21] In those cases, a failure to pay a cure would

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[19] *Federal Communications Commission v. NextWave Personal Communications, Inc.*, Nos. 01-653, 01-657, Brief for the Federal Communications Commission at 33 (filed May 2002) (*NextWave Brief*).

[20] *Id.* (emphasis added). *See also Federal Communications Commission v. NextWave Personal Communications, Inc.*, Nos. 01-653, 01-657, Reply Brief for the Federal Communications Commission at 12 (filed August 2002) ("a debtor's obligations under executory contracts cannot be eliminated while the debtor seeks to retain the benefits thereof").

[21] IDT Winstar, for example, has agreed to pay a cure on at least 4,500 leases for non-residential property and at least 15 software licenses. *See* Winstar Communications, Inc., Case No. 01-1430 (Jointly Administered) (Bankr. D. Del.), Docket Items 2160-2187, 2190-2220, 2222-2224, 2229-2230.

result in termination of the executory contracts with non-ILEC creditors, and thus force the CLEC-successors to discontinue service to end-user customers. There is no reason why a different result should apply here, nor is there any justification for affording ILEC-creditors less rights to a cure than other creditors, particularly as ILECs had no choice but to enter into interconnection agreements and other service arrangements with the bankrupt carriers. Accordingly, the Commission should clarify that the Communications Act does not create an implicit "telecom" exception to the Bankruptcy Code, and thus limit an ILEC's rights under section 365 by permitting a carrier to take the benefits of a bankrupt's service arrangement without paying a cure.

The Commission further should declare that, to the extent a carrier seeks to take the benefit of a bankrupt carrier's pre-existing service arrangements with no interruption, relocation or other change in service, the successor carrier must comply with tariff provisions requiring it to pay the outstanding indebtedness on those service arrangements.[22] Like section 365, these provisions ensure that a CLEC or other end user does not avoid payment for services by simply transferring existing service arrangements to a successor through a mere change in billing information and with no interruption, relocation or other change in service.

[22] *See, e.g.*, Southwestern Bell Tariff FCC No. 73, Section 2.2.1 ("where there is no interruption of user or relocation of the services [provided under this tariff], [an] assignment or transfer may be made to: (1) another customer . . . provided the assignee or transferee assumes all outstanding indebtedness for such services, the unexpired portion of the minimum period and the termination liability, if any . . ."). The federal tariffs of SBC's other telephone company subsidiaries contain virtually identical language.

V. CONCLUSION.

For the foregoing reasons, the Commission should: (1) permit carriers expeditiously to revise their tariffs to provide adequate assurance of payment for services rendered to financially troubled companies; (2) support ILECs' efforts in Bankruptcy Courts to obtain advance payment for services rendered to bankrupt companies; and (3) confirm that carriers seeking to take the benefits of existing service arrangements of bankrupt carriers must pay a cure for outstanding debts on those arrangements — consistent with bankruptcy law and federal tariffs.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Anisa A. Latif, do hereby certify that a copy of this filing, **Comments of SBC Communications Inc.,** has been served on the parties below via first class mail – postage prepaid on this 15th day of August 2002.

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